ZURICH

**Testimony of Constantinos ("Dinos") Iordanou**
**Senior Executive Vice President, Group Operations and Business Development**
**Zurich Financial Services Group**

**Before the**
**House Financial Services**
**Subcommittee on Capital Markets, Insurance and**
**Government Sponsored Enterprises**

**October 24, 2001**

Chairman Baker, Ranking member Kanjorski, members of the subcommittee, my name is Dinos Iordanou, and I oversee all business development and operational activities of the Zurich Financial Services Group. Zurich, one of the world's largest insurance companies, operates in nearly 60 nations globally, with the U.S. serving as its single largest market. In America, we employ over 35,000 workers and write more property casualty premiums than all but two of our competitors. Prior to assuming my current position in July, I served as CEO of Zurich North America, our flagship commercial lines carrier, and before that in a number of different positions with Zurich, AIG, and Berkshire Hathaway.

Since the September 11 attacks, the senior management team at Zurich has been confronted with a number of difficult issues. First and foremost, we had to cope with the fact that six of our employees were murdered simply for going to work that day. Secondly, we had to relocate 650 employees to assure continuity of our business operations. And thirdly, as a major insurer and reinsurer of commercial risks in New York and across the country, we needed to decide how to address the marketplace implications of this new and vicious form of risk.

This last decision – which is evolving constantly – also faces you, as policymakers for the federal government, and I commend you for holding this hearing today amidst the very real challenges facing you and your staff.

In the few minutes I have here this morning, I would like to outline for you the steps Zurich is taking to address what Vice President Cheney has referred to as the "new normalcy," and to describe how an insurance executive is likely to judge any government action taken to return stability to this marketplace.

In 2000, Zurich Financial Services Group wrote a total of $25.5 billion of net premiums, making it one of the 10 largest insurers in the world. In the U.S., Zurich North America's 2000 net premium volume was $3.5 billion, which was supported by a capital base of $2.161 billion. This asset base is significantly enhanced by the use of top-tier reinsurers around the world, and together these sources of capital allowed Zurich to provide innovative risk management products to corporate customers in all 50 states, ranging from the Fortune 100 to the smallest of businesses. It is important to note that even prior to September 11, though, market forces were creating significant upward pricing pressures, which were being felt in most commercial insurance lines. Thus, with premiums increasing and a strong balance sheet, Zurich managed its capital-to-risk ratios in such a way that maximized its appetite for risk while ensuring long-term financial stability for our client base.

The terrorist attacks, besides costing our company six valued employees and millions of dollars in relocation costs, cost the entire Zurich family between $700 and $900 million in losses, net of reinsurance. Clearly, this is a substantial amount, and will impact our revenue figures at year's end, a fact that analysts are watching very closely. However, one of Zurich's strengths is its global capital base, and the company will absorb these losses without long-term financial implications.

The decision facing us today, though, is how -- or whether -- we assimilate this new risk of terrorism into our risk portfolio, with the resulting exposures reflected in our now fully exposed capital allocations, since reinsurance for terrorism coverage is now unavailable in the private markets. At its core, the insurance function is an application of capital to risk; so the fundamental question facing Zurich today is how much, if any, of our capital base do we feel reasonably assured we can expose to terrorism risk while still providing the financial security and long-term stability required of our customers.

Today, the answer is very little, and then only for customer profiles that represent relatively remote targets of this new ambiguous risk. The primary reason for this is that absent reinsurance, our traditional risk-spreading mechanism, we can not adequately manage the concentration of risk that certain policyholders or groups of policyholders represent. In short, the new risk of terrorism simply overwhelms the traditional insurance mechanism.

What does that decision mean? Unfortunately, it means that at the time when they need it most, our largest and our smaller customers are being told that we can not renew their insurance coverages absent some way to exclude terrorism risks. The larger ones are being told so because they represent such high-dollar risks on their own, while the smaller ones are being told so because of potential aggregation problems that the industry is just now starting to appreciate. For example, prior to September 11, an insurer could comfortably write a building or a factory that represented a $1 billion risk because the carrier knew it could obtain per risk reinsurance coverage that allowed it to share that risk with others. Similarly, an insurer could also write a number of smaller risks in an office park or close proximity that totaled $1 billion because it could obtain catastrophe coverages from reinsurers that spread the risk beyond its own capital base. Today, that ability to share both per risk and aggregate risks is gone, rendering primary insurers financially incapable of assuming those risks. This new economic reality is a sad but very real indication of just how deeply the September 11 attacks altered our way of life.

As a trained engineer who has built his career on managing complex risks, it is personally very painful to acknowledge that a risk exists in our economy that I can not manage. However, absent any basis by which to actuarially price terrorism coverage, my duties to my customers and my shareholders force me to minimize the exposure of my capital base to this insidious new risk.

Without such drastic steps, though, we would be jeopardizing our ability to provide coverage for the multitude of other economic risks covered by our products – risks ranging from workplace injuries and product liability suits to e-commerce security lapses and employment practices. These are the risks that face businesses every day, and Zurich is committed to helping entrepreneurs and corporate leaders manage those risks in ways that allow American businesses do what they do best – produce the best goods and services available anywhere in the world.

Simply minimizing the impact of terrorism risk on Zurich's portfolio doesn't solve the problem, though; it simply transfers the risk back onto corporate America, and their financial partners. This means that lenders, shareholders and other creditors assume the risk instead of the insurance markets, a result that will likely lead to an immediate constriction in capital available to American businesses. Effectively, this scenario leaves the risk unmanaged, and poses a major financial threat to the U.S. economy. Chairman Baker, members of the subcommittee, I applaud you for recognizing the gravity of this situation, and for committing to address it through some federal role.

The private sector, left to its own to respond to this situation, would partially fill this void with some novel risk-management tools. However, the cost to the consumer for such tools would be prohibitive, and they would fail to provide sufficient capacity to address the multitude of exposed risks in the U.S. economy.

Any government solution, though, should be measured, and should focus on bringing sufficient stability back to the insurance markets so that companies like Zurich will feel comfortable including a degree of terrorism exposure in its risk portfolio. Remember, the essence of insurance is to efficiently apply capital to risk. So, the standard by which we will determine whether that goal has been met will be whether the degree and concentration of capital exposure presented by the prospect of future terrorist attacks is manageable. Too much exposure will force insurers to continue excluding terrorism risks from their coverages. However, we also recognize that if there's too little exposure to the insurance industry, U.S. taxpayers will shoulder the bulk of this new risk, and the political reality is that this is unacceptable. We accept and respect that reality.

The solution, then, will need to balance the industry's need for maximum stability, with the government's need for minimum exposure to the risk and involvement in the marketplace. I, for one, am confident that such a balance exists, and would urge all participants in this debate to focus on the common themes embedded in the options offered to date, instead of their shared shortcomings.

For example, the insurance industry's original proposal utilized a pooling structure to spread risks across the industry and accumulate private sector capital committed to covering terrorism risks. This is an approach that has long-standing use within the industry, and it's one that has served other nations well in their quest to address the economic realities of terrorism risk. We understand that the potential for large government exposure and the extent of interaction between the pool and the government caused concerns among many, but the underlying concept of facilitating the spreading of a this new form of risk is an important one that should not be abandoned. Ultimately, the success or failure of this effort will be judged on a risk-by-risk assessment, not by some broad industry aggregate, so there must be some component that serves as a proxy – even in the short-term – to the traditional reinsurance mechanism.

The White House has floated a different approach that utilizes a pro-rata risk sharing concept akin to the quota share arrangements prevalent in the private sector. It's a short-term stop-gap measure that increases the private sector retention in the second and third years, probably to levels that are beyond the industry's capacity to handle. Furthermore, there are a number of operational questions that would need to be answered before judging the effectiveness of this approach, such as how the government would contract with companies for the indemnification, and how the necessary terms and conditions would be made consistent throughout the risk chain. However, the proposal adopts an approach that addresses both per risk and aggregate exposures, and signals a very important recognition on the part of the Administration that the government does have a role to play in managing what are fundamentally political risks.

Both proposals, then, reflect an underlying concept of shared private and public sector responsibility, and with modifications – some major, some minor – could serve as the basis for a meaningful resolution to this problem.

In closing, I would suggest that anyone who views government involvement to address this market crisis as “bailout” may be underestimating the discipline of the private markets. The actions Zurich and other insurers are taking to minimize their exposure to terrorism risks are firmly in line with economic reality: our capital is finite, but the risk is infinite. Thus, if there is any “bailing” out occurring, then, it is the natural and expected flight of capital away from terrorism risk. This should not be surprising, since it is how markets operate, and it reflects an immediate manifestation of how the capital markets are responding to the “new normalcy” of post-September 11 American life.

Thank you for allowing me the time to present you with Zurich’s perspective of this important issue, and I look forward to answering any questions you might have.

###

Contact Information:

Francis Bouchard
Senior Vice President & Director, Government Affairs
Zurich Financial Services Group
1201 F Street, NW, Suite 250
Washington, D.C. 20004
Phone: 202-585-3150
Fax: 202-628-2658